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INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC
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RUEHPW/AMCONSUL PESHAWAR 5025
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL
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SENSITIVE
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TAGS: ECON EFIN PREL PK
SUBJECT: FOREIGN RESERVES CONTINUE TO FALL AND LACK OF LIQUIDITY SQUEEZES MARKETS

¶1. (SBU) Summary: Pakistan's foreign exchange reserves fell to USD 4.3 billion on October 10 and the GOP has decided to reduce petroleum reserves to 10 days instead of 21 days in hopes of reducing the outflow of dollars. Pakistan's stock markets and inter-bank market continue to experience liquidity shortages. The State Bank of Pakistan (SBP) took various measures to ease liquidity in the inter-bank market, including raising the limits for using Pakistan Investment Bonds and Treasury Bills to meet the statutory liquidity requirement and allowing the use of investment in Pakistan Investment Bonds and Treasury Bills for borrowing from the State Bank of Pakistan under its discount window. Pakistan's stock exchanges are suffering a liquidity crunch in the continuous funding system (CFS) which lends money for equity investment. The financial institutions' reluctance to provide funds in the CFS market has further aggravated the situation. In a meeting on October 13 the financial institutions assured Securities Exchange Commission Pakistan (SECP) and Karachi Stock Exchange (KSE) they would provide funds in the CFS market, although there was no agreement on concrete measures. End Summary.

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FOREIGN EXCHANGE RESERVES
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¶2. (SBU) Foreign exchange reserves have again dipped to USD 4.33 billion on October 10, 2008 reflecting a drop of 530 million dollars for the week of October 3. Pakistan's foreign exchange reserves had improved marginally to USD 4.86 billion on September 30 after disbursement of Asian Development Bank loan of USD 500 million. The rapid depletion of the foreign exchange reserves is attributed to debt servicing, import financing and an unusual intervention in the inter-bank market on October 9, when the SBP injected USD 100 to 200 million into the currency market to stop the rapid fall of the rupee.

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REDUCTION IN OIL RESERVES TO CONSERVE DOLLARS
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¶3. (SBU) Secretary G.A. Sabri of the Ministry of Petroleum and Natural Resources told EconOff that the government has decided to maintain reserves of petroleum products for 10 days instead of 21 days in order to reduce the outflow of dollars. He said "the decision will bolster the country's foreign exchange reserves."

¶4. (SBU) For the first two weeks of October, the GOP was paying a subsidy of PKR 8.21 per liter on kerosene, PKR 7.41 on light diesel

oil and PKR 6.42 per liter on high speed diesel; adding up to a monthly subsidy of PKR 1.7 billion. Tahmoor Azmat Osman, Joint Secretary Ministry of Petroleum told EconOff that the government has to pay over PKR 40 billion to oil marketing companies and refineries on account of accumulated price differential claims (i.e. subsidies). Osman said that "the outstanding amount could only be paid through earnings from gasoline and diesel in the wake of declining crude oil prices in the international market." (Comment: Post is seeking clarification on this acknowledged debt. Post believes that Osman is referring to debt to the independent power producers who are currently producing below capacity due to non-payment. U.S. energy companies such as Chevron and AES are owed approximately USD 275 million for energy production (Septel).)

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SBP MOVES TO END LIQUIDITY CRUNCH
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¶5. (SBU) On October 17, the SBP took new measures to alleviate the liquidity crunch in the money market.
As part of their obligation to meet statutory liquidity requirements, banks may maintain up to 5 percent of their time and demand liabilities (currency deposits with a minimum term before withdrawal and those that can be withdrawn at any time, respectively) in the form of Pakistan Investment Bonds and Term Finance certificates. Effective October 18, the SBP has decided to increase this limit to 10 percent. The additional 5 percent increase can only be met through investment in Pakistan Investment Bonds. The SBP has also decided to immediately allow the use of market treasury bills and Pakistan Investment Bonds for borrowing under the SBP discount window, to the extent investment in these

securities is in excess of the limit prescribed for statutory liquidity requirements.

¶6. (SBU) This is the central bank's second move to increase liquidity in the money market within the last seven days. Earlier, during the week of October 6-10, the SBP announced a relaxation in the cash reserve requirement and reduced it by 2 percent, from 9 percent to 7 percent. In spite of this, the market was still experiencing a liquidity shortage, compelling banks to acquire money on higher overnight call rates. Last week the overnight rates shot up to highs of 35-40 percent.

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FINANCIAL INSTITUTIONS AGREE TO KEEP CFS MARKET FLUID
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¶7. (SBU) Securities and Exchange Commission of Pakistan (SECP) chairman, Razi-ur-Rehman, said that after a marathon meeting of the SECP and KSE with banks and mutual funds on October 13, the regulators had managed to persuade institutional investors not to withdraw committed funds from the CFS market in order to prevent depletion of market liquidity and endangerment of the financial system. (Comment: the CFS market functions similarly to lending on the margin in the U.S. End Comment.)

¶8. (SBU) The stock markets' troubles were exacerbated on October 10, following the financiers' decision to halt the flow of new funds into the CFS because of the perception of rising risk. After discussions, the banks and mutual funds gave an assurance that they would carry on with their current commitments in the CFS market and not withdraw funds. According to KSE Board member Junaid Mirza there was still a question mark as to whether the committed funds would arrive in the market as the financial institutions had not agreed to any concrete measures.

¶9. (SBU) The National Investment Trust, Pakistan's largest mutual fund with PKR 80 billion under management, has begun to set up a new PKR 20 billion fund for equity investment called the "Pakistan State Enterprise Fund." Media sources report that the government wanted the fund to be ready for investment in equity markets by October 27, when the KSE floor on shares prices is likely to be lifted. Mr. Shaukat Tareen, Adviser to the Prime Minister on Finance, had

earlier expressed his disapproval of the KSE floor which has frozen the stock market at the level of 9,144 points since August 27.

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